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STATE FOR EAP/CM AND EEB/OMA, TREASURY FOR OASIA

E.O. 12958: N/A
TAGS: ECON EFIN EINV ETRD HK CH
SUBJECT: US Auto Bailout Drives Hang Seng Volatility

¶1. Summary: The Hong Kong government's announcement that it would greatly expand an SME loan guarantee program pushed Hong Kong stocks higher this week, before profit taking and news that the U.S. Senate had rejected a bill to bail out U.S. automakers drove the market down on Friday. Hong Kong economists and bankers cited basic economic principles as they agreed that the RMB's recent depreciation is a short-term correction and predicted the RMB will strengthen further as the U.S. economy weakens. End Summary.

Support for SME's Good for Hang Seng

¶2. Hong Kong's Hang Seng Index rose sharply this week as the government announced that it would expand a loan guarantee facility for Small and Medium Enterprises (SMEs) from HKD 10 billion (US$ 1.29 billion) to HKD 100 billion (US$ 12.9 billion) and raise the limit for each borrower from HKD 1 million (US$ 129,000) to HKD 6 million (US$ 774,000). The HKD 100 billion pledge commits about 25 percent of Hong Kong government reserves. The markets reacted positively, gaining over 11 percent from the previous Friday close, before sliding sharply on Friday, December 12.

¶3. The Hang Seng lost over 1000 points in Friday morning trading before recovering in the afternoon to close at 14758.39, down 855.51 points or 5.48 percent from Thursday. For the week, the Hang Seng Index was still up 6.6 percent or 912.30 points. Volume on Friday was a relatively brisk HKD 58.8 billion. Market watchers blamed profit taking and the failure of the U.S. Senate to reach an agreement on loans to the big three U.S. automakers. HIBOR quoted by Hang Seng Bank this afternoon stood at 0.15 percent for overnight, 0.95 percent for one-month and 1.65 percent for three month borrowing.

¶4. The SME loan guarantee proposal will reportedly be extended to all privately held companies. If the Legco approves, commercial banks in Hong Kong could begin to accept applications from Hong Kong enterprises for loans up to HKD 6 million each as early as next Monday, December 15. The Hong Kong government estimated that 10 percent of enterprises might be unable to repay loans, but judged this an acceptable non-performing loan risk.

¶5. In response to the government's call to loosen credit for SMEs, HSBC, Standard Chartered Bank, Bank of China, and Bank of East Asia all announced plans this week to reserve a special pool of funds for SME loans. However, the banks declined to commit to fixed low interest rates for SME borrowers. SME loans are expected to carry an interest rate of prime (currently 5 percent) plus one to four percent, depending on the borrower.

RMB Depreciation Short-Term Only Say HK Observers

¶6. Local economists and bankers agreed that the RMB's recent depreciation is most likely a short-term adjustment. They predicted that the RMB would continue to appreciate against the U.S. dollar next year as China's economy remains stronger than many others more affected by the global financial crisis. Standard Chartered's Senior Economist Nicholas Kwan told pro-Beijing newspaper Wen Wei Po

Friday that the RMB would not depreciate sharply, though it might soften over the next year due to the slowing Chinese domestic market. Kwan added that he believes the HKD will also weaken next year. He projected Hong Kong's economic outlook in 2009 will continue to deteriorate but that the damage will not be comparable to the economic impacts of SARS in 2003 or the Asian financial crisis in 1998.

¶7. Credit Suisse Economist Tao Dong told the Chinese press that the current RMB depreciation is a normal correction after appreciation of over 20 percent since the end of the peg. Tao predicted that the RMB will continue to depreciate for another 6 months before strengthening again. BOCHK Chief Executive He Guangbei told Wen Wei Po that the RMB could float upward or downward in accordance with its international trade balance. (Note: That obviously doesn't explain why the RMB would depreciate after China announced yet another large trade surplus. Pro-Beijing press didn't comment on speculation that the Chinese government might consider pushing the RMB down to promote export competitiveness. End Note.) He added that no regulations forbid the RMB from depreciating.